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UNCLAS SECTION 01 OF 02 ANKARA 004095

SIPDIS

SENSITIVE

TREASURY FOR OASIA - LOEVINGER, MILLS, ADKINS
NSC FOR BRYZA AND MCKIBBEN

E.O. 12958: N/A
TAGS: EFIN PREL TU
SUBJECT: TURKEY READY FOR FOR 8TH IMF REVIEW, 2005 STILL UP IN THE AIR

REF: ANKARA 3662

SENSITIVE BUT UNCLASSIFIED. MARKET SENSITIVE NOT FOR NON-USG RELEASE.

¶1. (SBU) Summary. The IMF Executive Board has scheduled its eighth review of Turkey's performance under its stand-by program for July 30. The Board will also discuss an IMF staff "Article IV" report on Turkey's economic developments and policies over the last three years. Turkish officials and the IMF resrep expect the Board meeting to go smoothly, although they acknowledged that the discussions leading up to the board meeting were more protracted than expected. An IMF mission in September will discuss the ninth review, which should go to the Board in October, as well as Turkey's relationship with the IMF after the stand-by expires in early February 2005. End Summary.

## 8th Review

¶2. (SBU) On July 16, Turkish authorities signed a letter of intent with the IMF for completion of the 8th review of its current Stand-by Arrangement with the IMF. The signing came nearly a month after the departure of the country team review mission (reftel) and during the last hours of parliament's session before going on its summer recess. At the completion of the review mission, there were three unmet structural benchmarks that delayed what perhaps should have been an easier process given higher than expected GDP growth, strong fiscal results and continued disinflation. (Structural "benchmarks" are not formal requirements necessary for completion of reviews, but are indicators that the Fund uses to assess performance under a program.)

-- The first such benchmark concerned petroleum excise taxes, which the GOT had been reducing as a way to keep fuel prices low in the face of the current high global oil price environment. The Fund argued that this was a departure from the established framework for taxation ) a recurrent issue with Turkish fiscal policy -- and that it was unwise given the widening current account deficit. IMF staff and the GOT finally agreed to reinstate the excise tax at close to the level assumed in the budget, thus partially fulfilling the benchmark.

-- Second was the benchmark related to the process of privatization of state banks. In one of its last actions before going on recess on July 16, the parliament passed a law approving the merger of state-owned Halk bank with Pamukbank, a troubled private sector lender taken over by the Savings Deposit Insurance Fund (SDIF). This, along with publication of a privatization strategy for the merged bank, served to partially satisfy the IMF benchmark. Publication of privatization strategies for state-owned banks Ziraat and Vakif has yet to occur.

-- The final issue holding up the letter of intent was passage of legislation providing for a separate revenue office under the Ministry of Finance, which the Fund had originally sought to have passed in May. The IMF had hoped to see this legislation enacted before the board meeting. Despite the goverment's efforts, however, parliament was unable to complete action before going on recess. The GOT and IMF agreed that passage of the legislation would be elevated to the level of a formal performance criterion to be met prior to the ninth review.

¶3. (SBU) Another issue not included as a specific benchmark in the program, but that surfaced during the discussion surrounding the signing of the LOI was that of local government debt. During its last week, parliament passed a new local administration law that sets limits on municipality borrowing and addresses the restructuring of current arrears on Treasury-guaranteed liabilities. The IMF and World Bank

were concerned about this law due to its implications for debt management and debt sustainability, but the GOT actively prevented their involvement in its design. The law is part of the AK party decentralization agenda; how it will be implemented will continue to be a subject of discussion for the Fund.

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POST FEBRUARY 2005 RELATIONSHIP WITH IMF
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¶4. (SBU) In several meetings with the Turkish Treasury, we have been able to get few specifics on thinking about the economic framework for 2005. The GOT is currently preparing a three-year program that will orient budget and financing strategies going forward with a goal of continued debt reduction through a high primary surplus, according to Treasury U/S Canakci. The GOT recently announced broad targets for next year, including GDP growth of 5%, an inflation rate of 8%, and an exchange rate of 1.7 New Turkish Lira (i.e. 1,700,000 current lira) per dollar. Other key variables such as the role of the IMF and size of the primary surplus are still under discussion and are not set to be announced until September. In a recent conversation with embassy economic section, Canacki made a reference to a successor IMF program by stating "the need for external anchors has to decline".

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FURTHER PRIVATE SECTOR CRITICISMS
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¶5. (SBU) Adding to the private sector criticism of the IMF voiced to the embassy by former GOT officials (reftel), another ex-official now consulting for a major bank raised concerns that the Fund has been "too easy" on the GOT. He specifically mentioned the new local administration law and the lack of IFI involvement in its design, explaining that it was not strict enough in limiting municipalities ability to incur debt. (Note: the Deputy Director General of Budget and Fiscal Control at the Ministry of Finance expressed similar discontent in another meeting with econ officers.) The consultant also spoke more generally about how markets have off-loaded the role of economic policy watchdog to the IMF and World Bank and that the GOT should do more to demonstrate to markets its ownership of economic reform.

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COMMENT
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¶6. (SBU) The delays in signing the letter of intent and scheduling the Board meetings highlighted the risk of complacency about structural reforms that post has described in previous reporting. Rather than easing enactment of crucial structural reforms, better than expected growth and disinflation are perversely making the politics of reform more difficult for the government to manage. During her recent visit to Turkey, State/EUR DAS Kennedy reinterated our message on the centrality of maintaining market confidence. We are taking advantage of other opportunities to reinforce this message. The process of designing a new three-year program is positive in that it may address complaints that the GOT was simply interested in how much financing the IMF could make available without demonstrating "owned" a coherent framework that financing would support. At the same time, however, lack of clarity about a follow-on relationship with the IMF serves to exacerbate market uncertainty regarding future Turkish policy.
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